

**Letter of Findings: 08-0334R
Indiana Corporate Income Tax
For the Tax Years 2000-2003**

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ISSUES

I. Gross Income Tax—Receipts from Services Provided in Indiana.

Authority: IC § 6-2.1-2-2; IC § 6-8.1-5-1; [45 IAC 1.1-1-3](#); [45 IAC 1.1-2-5](#); Enterprise Leasing Company of Chicago v. Indiana Dep't of State Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002).

Taxpayer protests the denial of refund and assessment of additional corporate income taxes based upon the method the Department used to source receipts from the performance of services in Indiana.

II. Adjusted Gross Income Tax—Receipts from Services Provided in Indiana.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; [45 IAC 3.1-1-52](#); [45 IAC 3.1-1-55](#); May Dep't Store Co. v. Indiana Dep't of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001).

Taxpayer protests that the Department erred in determining that gross receipts received for performing services in Indiana should be included in the sales factor used in determining Taxpayer's adjusted gross income tax liability.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation that is doing business in Indiana. Taxpayer renders "inventory control/logistics services"—i.e., warehousing services including packaging, labeling, and inventory management—at six Indiana warehouse locations (hereafter, "warehousing services"). Taxpayer has Indiana employees at each of those locations. Taxpayer filed amended returns for the 2000 and 2001 tax years claiming refunds based upon a reduction of corporate income taxes. Pursuant to an audit, the Indiana Department of Revenue ("Department") denied Taxpayer's 2000 and 2001 refund claims and assessed corporate income taxes for the 2003 tax year. Taxpayer protested both the 2000 and 2001 refund denials and the 2003 assessment. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Gross Income Tax—Receipts from Services Provided in Indiana.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that all the receipts that Taxpayer received for the provision of warehousing services in Indiana warehouses were Indiana source income subject to Indiana gross income tax under IC § 6-2.1-2-2(a)(2). The gross income tax was repealed in 2003.

IC § 6-2.1-2-2(a)(2) imposed an "income tax, know as the gross income tax... upon the receipt of the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary of Indiana." [45 IAC 1.1-2-5\(a\)](#) provided that "[g]ross income derived from the provision of a service of any character within Indiana is subject to the gross income tax."

The Indiana Tax Court has explained the applicability of gross income tax to nonresidents, and determined that there are three steps to reach such a decision. In Enterprise Leasing Company of Chicago v. Indiana Dep't of State Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002), the court explained:

To determine whether gross income is derived from an Indiana "source," the Court must (1) isolate the transaction giving rise to the income ("the critical transaction"), (2) determine whether the Petitioners have a physical presence in, or significant business activities within the taxing state ("business situs"), and (3) determine whether the Indiana activities are related to the critical transaction and are more than minimal, not remote or incidental to the total transaction ("tax situs").

Id. at 1290 (citations omitted).

In this case, the critical transaction was Taxpayer's customer's purchase of warehousing services. Further, Taxpayer did have a business situs in Indiana because Taxpayer was performing services in Indiana as provided in [45 IAC 1.1-1-3\(b\)\(2\)](#). Therefore, the remaining issue is whether or not Taxpayer's Indiana activities were related to the critical transaction and were more than minimal, and not remote or incidental to the total transaction, thereby giving Taxpayer a "tax situs." Taxpayer admits that Taxpayer had a "tax situs" and the service contracts that Taxpayer entered into with its customers provided for services in Indiana.

However, Taxpayer asserts that service receipts are governed by [45 IAC 1.1-2-5\(e\)](#), which stated:

When a contract provides for the provision of services in a state besides Indiana, gross income derived from the provision of services within Indiana will be determined by multiplying the gross income derived from the contract by the ratio of Indiana activities to total activities provided under the contract. The activities used will

be only those related to the services performed and reasonably calculated to effectuate an equitable allocation and apportionment of the taxpayer's gross income under the contract. However, if the percentage of Indiana activities to total activities under the contract is less than five percent (5 [percent]), then the entire proceeds of the contract received in that year are exempt from the gross income tax.

Taxpayer has provided three of its logistics service agreements for three of its six customers with Indiana warehouse locations. The first agreement starting on September 9, 2002, provides for services to be performed at one location in Plainfield, Indiana. The second agreement, signed in August of 2003, while it was not provided with all the referenced exhibits, was provided with the exhibit that allocates the fees separately for each of the six multi-state warehouse locations involved. The third agreement provides for services to be performed starting on August 17, 2000, and includes an exhibit that allocates the fees separately for each of the three multi-state locations involved. This agreement also provided for a general manager and office to be maintained at the Indiana location. The logistics service agreements for the other three customers with Indiana warehouse locations were not provided.

Taxpayer originally filed its 2000 and 2001 corporate income tax returns reporting the total of all the receipts that Taxpayer billed to its customer's for services in the Indiana warehouses in its Indiana sourced gross income. In its amended returns, Taxpayer proposed that only 88.42 percent of those originally reported receipts for the 2000 tax year, and 90.46 percent of those originally reported receipts for the 2001 tax year, were Indiana source gross income. Taxpayer maintains that these percentages were derived by taking the ratio of its "Indiana activities" to its "total activities" to source the receipts to Indiana as provided in [45 IAC 1.1-2-5\(e\)](#). While Taxpayer has not provided the detail of how it arrived at these percentages, Taxpayer made assertions that the difference in the "Indiana activities" to its "total activities" arises because of the information services it provides at its Illinois headquarters.

Notwithstanding that Taxpayer has not met its burden because it did not provide support for how it arrived at its percentages, Taxpayer is mistaken in applying [45 IAC 1.1-2-5\(e\)](#). Taxpayer's customers have not been charged one price under a contract requiring multi-state services that need to be allocated, but have been invoiced by Taxpayer on a monthly basis with the service charges allocated to each of the different warehouses. In fact, the service contracts themselves separately allocated the different service fees for the activities in each of the warehouses. Additionally, the Illinois activities to which Taxpayer refers are merely incidental to Taxpayer's provision of warehousing services in Indiana, which constitutes the "critical transaction."

FINDING

Taxpayer's protest is respectfully denied.

II. Adjusted Gross Income Tax— Receipts from Services Provided in Indiana.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer's gross receipts, which were shown on the customers' bills as received for performing warehousing services in Indiana, should be included in the sales factor numerator used in determining Taxpayer's adjusted gross income tax liability.

IC § 6-3-2-1 imposes a tax "on that part of the adjusted gross income derived from sources within Indiana of every corporation." IC § 6-3-2-2, in relevant part, provides:

(a) With regard to corporations. . . "adjusted gross income derived from sources within Indiana" for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state....

In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana....

(b) Except as provided in subsection (l), if business income of a corporation... is derived from sources within the state of Indiana and from sources without the state of Indiana, then the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three (3)....

"The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e). "The numerator of the sales factor generally includes gross receipts from sales attributable to this state, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales." [45 IAC 3.1-1-52](#).

Taxpayer has provided logistic service agreements for three of its six customers with Indiana warehouse locations. The first agreement starting on September 9, 2002, provides for services to be performed at one location in Plainfield, Indiana. The second agreement, signed in August of 2003, while it was not provided with all the referenced exhibits, was provided with the exhibit that allocates the fees separately for each of the six multi-state warehouse locations involved. The third agreement provides for services to be performed starting on

August 17, 2000, and includes an exhibit that allocates the fees separately for each of the three multi-state locations involved. This agreement also provided for a general manager and office to be maintained at the Indiana location. The logistics service agreements for the other three customers with Indiana warehouse locations were not provided.

Taxpayer originally filed its 2000 and 2001 corporate income tax returns including all gross receipts—which were shown on the customers' bills as received for performing warehousing services in Indiana—in the sales factor numerator. In its amended returns, Taxpayer proposed that the receipts should not be included in the sales factor numerator.

Taxpayer maintains that its warehousing services receipts were received for services that were performed within and without Indiana. Thus, Taxpayer asserts that the proper method of determining whether its warehousing services receipts are attributable to Indiana in the numerator of the sales factor is the cost of performance method as provided in IC § 6-3-2-2(f) and [45 IAC 3.1-1-55](#). According to Taxpayer, under the cost of performance method, Taxpayer should have sourced all its warehousing services receipts to Illinois. Therefore, Taxpayer maintains that all its warehousing receipts are properly sourced outside Indiana, are not attributable to Indiana, and should be excluded from the Indiana sales factor numerator.

However, Taxpayer fails to consider that the receipts from its warehousing services constitute a principal source of business income. IC § 6-3-1-20 defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business." For purposes of adjusted gross income tax, business income is apportioned between Indiana and other states using a three factor formula. IC § 6-3-2-2(b). In contrast, non-business income is allocated to Indiana or it is allocated to another state as provided in IC § 6-3-2-2(g) to (k). Thus, "whether income is deemed business income or non-business income determines whether it is allocated to a specific state or whether it is apportioned between Indiana and other states [in which] the taxpayer is conducting its trade or business." *May Dep't Store Co. v. Indiana Dep't of State Revenue*, 749 N.E.2d 651, 656 (Ind. Tax Ct. 2001). Thereafter, [45 IAC 3.1-1-55](#), in relevant part, provides:

[R]eceipts from sales other than sales of tangible personal property which constitute a principal source of business income shall be attributed to this state in accordance with the following...

(d) If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such service elsewhere....

Therefore, since the receipts from the warehousing services represent business income of Taxpayer, Taxpayer cannot use the cost of performance method to determine if the receipts are attributable to Indiana. The proper method to attribute the Indiana receipts for services that are performed within and without Indiana is described in [45 IAC 3.1-1-55\(d\)](#). Accordingly, once Taxpayer has demonstrated that it has received receipts from services that are performed within and without Indiana and has used the method in [45 IAC 3.1-1-55\(d\)](#), then Taxpayer can determine the receipts, from the services that are performed within and without Indiana, which are attributable to Indiana for the sales factor numerator.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

In summary, Taxpayer's protests of Issues I & II are denied.

Posted: 11/26/2008 by Legislative Services Agency
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